D.T.E. 2-1

Prepared by: Joseph A. Ferro

Request: Please discuss fully the economic and other rationales that would justify why Bay State Gas Company's ("Bay State" or "Company") would enter into this $39 thousand contract just to receive only $332 annually more than the marginal costs associated with that contract with Middleborough Gas & Electric Department ("Middleborough"). Please respond in the context of Bay State's updated marginal cost study which, as the Company has indicated, was developed "...to insure that its business decisions are well founded on economic principals."

Response: There are four principal economic rationale for entering into this contract:

1. The long run marginal costs used to measure contract costs include all costs expected in the long run including allowed return and associated taxes. Thus, the $332 contract excess represents an increase in return causing the project's return to exceed that found appropriate in the Company's last general rate case.
2. Long run marginal costs, while typically employed by the DTE to benchmark special contracts are not the theoretically appropriate benchmark for examining special contracts of fixed duration and with no continuing obligation to serve. In these instances, site specific incremental costs are more appropriate. Over the contract term, the Company expects to utilize existing and available distribution capacity without incurring any local reinforcement costs. Thus the incremental costs for reinforcements are zero in contrast with the long run marginal cost study's estimate of reinforcement costs of $19.364 per design day MMBtu. This unit cost derived annual costs of $38,728 in connection with satisfying Middleborough's maximum daily requirement of 2,000 MMBtu.
3. The use of temporarily excess distribution capacity for a limited duration contract is an ideal use of resources. It generates incremental revenues at the present time and preserves this capacity to serve future loads of the Company's core customers at a later date, if required by localized load growth.
4. On rare occasions the Company has entered into contracts to provide or receive distribution pressure support from neighboring utilities that result in substantial savings in comparison to the construction alternative. For example, the Company is currently providing pressure support to a remote area of Boston Gas's service territory that is adjacent to Bay State's service territory. By offering such services to adjacent local distribution utilities while incurring little or no incremental cost,

the Company continues its good neighbor policy and can maintain a positive relationship that could result in beneficial cooperation in the future.

D.T.E. 2-2

Prepared by: Joseph A. Ferro

Request: Provide a copy of each document that includes an analysis, evaluation or opinion as to the reason(s) to justify why Bay State Gas Company's ("Bay State" or "Company") would enter into this $39 thousand contract just to receive only $332 annually more than the marginal costs associated with that contract with Middleborough.

Response: A copy of the Company's ten year distribution reinforcement study for the Brockton division is attached. It indicates that even under a high load growth scenario, no reinforcements will be necessary in the area of the distribution system used to provide the contract's transportation service.

D.T.E. 2-3

Prepared by: Joseph A. Ferro

Request: For each of the past five years, please identify the net margins (separately for commodity and capacity) generated from the Middleborough contract.

Response: The net margin generated from the Middleborough contract is solely the entire transportation or net base rate charged to Middleborough and other Off-system sales customers. Thus, the net margins can be considered local distribution capacity related. Please see Attachment DTE-2-3 for the derivation of those net margins for the past five Off-system peak period seasons.